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BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF CALIFORNIA

In the Matter of Application of Volcano Telephone Company (U 1019 C) to Modify Intrastate Revenue Requirement and Rate Design and Adjust Selected Rates.	A.21-11-006

APPLICATION OF

VOLCANO TELEPHONE COMPANY (U 1019 C) AND VOLCANO VISION, INC.

FOR REHEARING OF DECISION 23-02-008

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I. INTRODUCTION.

Pursuant to Rule 16.1 of the Rules of Practice and Procedure ("Rules") of the California Public Utilities Commission ("Commission"), Volcano Telephone Company ("Volcano") and Volcano Vision, Inc. ("Volcano Vision") (collectively, "Applicants") apply for rehearing of Decision ("D.") 23-02-008 (the "Decision"), which was formally issued on February 3, 2023. This Application for Rehearing is timely because it is within the 30-day timeframe prescribed by Public Utilities Code Section 1731. Applicants are authorized to seek rehearing because Volcano was a party to the underlying proceeding and Volcano Vision is an affiliated Internet Service Provider ("ISP") that is "pecuniarily interested in the public utility affected" by the Decision, which implements the Commission's broadband imputation policy as to Volcano and Volcano Vision and mandates Volcano and Volcano Vision to track broadband service quality metrics and comply with broadband service quality reporting requirements.[1]

Applicants seek rehearing of five aspects of the Decision, each of which merits adjustments to the Decision to avoid legal error.[2] *First*, the last-minute addition to the Decision to impose onerous broadband service quality tracking and reporting requirements on Volcano and Volcano Vision exceeds the scope of Volcano's rate case and the Commission's jurisdiction, is unsupported by the Decision's findings and substantial record evidence, constitutes an abuse of discretion, and violates Volcano's and Volcano Vision's constitutional rights to due process and equal protection.[3]

Second, the Decision's failure to adjust the corporate and operating expense caps and Volcano's operating expenses by appropriate levels of inflation to match the 2023 test year fails to comply with longstanding test year ratemaking requirements, is unsupported by the Decision's

[1] Any "other party pecuniarily interested in the public utility affected" by a Commission decision "may apply for a rehearing in respect to matters determined in the action or proceeding and specified in the application for rehearing." Pub. Util. Code § 1731(b); *see also* D.92-02-076, 1992 Cal. PUC LEXIS 937, *4 (Applicants who were not parties to the action "may apply for rehearing in their own rights" because the Resolutions at issue impacted "'other [parties] pecuniarily interested in the public utility affected.'") (emphasis removed from original).

[2] In limiting rehearing to these issues, neither Volcano nor Volcano Vision concedes that the Decision is otherwise lawful. Volcano identified several other legal errors in its comments on the Proposed Decision that have not been corrected and remain in the Decision. Volcano reserves the right to challenge these other findings and conclusions in future proceedings and/or through means other than this Application for Rehearing. *See Volcano Opening Comments on Proposed Decision* at 12:3-16:2, 17:9-18:21.

[3] Pub. Util. Code §§ 1757(a)(1), (2), (3), (4), (5), (6).

findings and substantial record evidence and constitutes an abuse of discretion.[4]

Third, the Decision's reduction of taxable income in response to broadband imputation violates clear Commission directives, unjustifiably departs from Commission precedent, is unsupported by the Decision's findings and substantial record evidence and constitutes an abuse of discretion.[5]

Fourth, in implementing the Commission's "broadband imputation" policy and incorporating Volcano Vision's non-regulated net revenues from 2020 into Volcano's regulated rate design, the Commission creates an unlawful shortfall in Volcano's California High Cost Fund A ("CHCF-A") support amount, rendering Volcano's revenues $1,592,174 lower than necessary to recover Volcano's revenue requirement.[6] This results in an unconstitutional taking of utility property that conflicts with binding United States Supreme Court authority confirming that state utility commissions may not force public utilities to fulfill their regulated revenue requirements through non-regulated affiliate revenues.[7] For the same reasons, the implementation of broadband imputation in this rate case violates statutory requirements mandating that revenue requirement and rate design must be equal.[8] Moreover, in indirectly confiscating Volcano Vision's revenues through this regulated ratemaking mechanism, the Decision irreconcilably conflicts with the Federal Communications Commission's ("FCC")

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[4] Pub. Util. Code §§ 1757(a)(2), (3), (4), (5).

[5] *Id.*

[6] *See Decision*, Appendix A. The Fifth District Court of Appeal recently rendered a partially published Opinion upholding the Commission's broadband imputation policy in connection with the CHCF-A rulemaking. *See Calaveras, et al. v. Pub. Util. Comm'n* (2022) 87 Cal.App.5th 793. Volcano and Volcano Vision have nevertheless included the legal errors related to broadband imputation in this Application for Rehearing because their appellate rights have not been exhausted in connection with the facial challenge to broadband imputation. In addition, the Fifth District found that Volcano's takings claims were unripe pending implementation of broadband imputation in a rate case. *See Calaveras, et al. v. Pub. Util. Comm'n* (2022) 2022 Cal.App.Unpub.LEXIS 7816 at *49 (unpublished version).

[7] *Brooks-Scanlon Co. v. Railroad Comm'n of Louisiana* (1920) 251 U.S. 396, 397, 399 (striking down state commission order measuring public utility revenue by including non-utility revenue); *see also* U.S. Const., amends. V, XIV; Cal. Const., art. I, § 19; *Duquesne Light Company v. Barasch* (1989) 488 U.S. 299, 308 ("If the rate does not afford sufficient compensation, the State has taken the use of utility property without paying just compensation and so violated the Fifth and Fourteenth Amendments."); *Federal Power Commission v. Hope Natural Gas Co.* (1944) 320 U.S. 591, 603.

[8] Pub. Util. Code §§ 275.6(b)(4), (b)(3), (b)(5); *see also Pacific Tel. & Tel. Co. v. Pub. Util. Comm'n* (1965) 62 Cal.2d 634, 644-645; *City and County of San Francisco v. Pub. Util. Comm'n* (1985) 39 Cal.3d 523, 531.

classification of broadband Internet access service as an "information service,"[9] thereby triggering conflict preemption. In endorsing these outcomes, the Commission has "acted . . . in excess of . . . its powers or jurisdiction," "not proceeded in the manner required by law," abused its discretion, and violated Volcano's and Volcano Vision's constitutional rights.[10]

Fifth, the Commission abused its discretion in refusing to incorporate a mechanism into the Decision to reverse the effects of broadband imputation if the policy is deemed unlawful by a reviewing court. While the Fifth District Court of Appeal recently rendered an Opinion that rejected Volcano's statutory arguments, found its federal preemption arguments inapplicable, and found its takings arguments "unripe,"[11] Volcano's rights to appellate review of the decisions adopting broadband imputation are not exhausted, and the Independent Small LECs[12] and their ISP affiliates (including Volcano and Volcano Vision) filed a Petition for Review with the California Supreme Court on February 27, 2023.[13] In addition, the takings argument remains a viable basis for challenging the outcome of this rate case under the Fifth District's Opinion.[14] Volcano made a reasonable proposal to incorporate into the Decision a procedural mechanism for restoring Volcano's full CHCF-A draw through a Tier 2 advice letter process in the event that broadband imputation is reversed or annulled.[15] The Decision rejects that proposal without acknowledgment or explanation, thereby making its determination an arbitrary and capricious

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[9] *In the Matter of Restoring Internet Freedom*, WC Docket No. 17-108, *Report and Order, et al.,* FCC 17-166 (rel. Jan. 4, 2018) ("*RIFO*") at ¶ 20, *petition for review granted in part on other grounds and denied in part by Mozilla Corp. v. Fed. Commc'ns Comm'n* (D.C. Cir. 2019) 940 F.3d 1, 35 (upholding the FCC's classification of broadband Internet access as an "information service"); *Geier v. American Honda Motor Co.* (2000) 529 U.S. 861, 873 (conflict preemption applies where a regulation "'under the circumstances of a particular case . . . stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress—whether that 'obstacle' goes by the name of conflicting; contrary to; . . . repugnance; difference; irreconcilability; inconsistency; violation; curtailment; interference, or the like.") (*quoting Hines* v. *Davidowitz* (1941) 312 U.S. 52, 67).

[10] Pub. Util. Code §§ 1757(a)(1), (2), (5), (6).

[11] *Calaveras, et al.*, *supra,* 2022 Cal.App.Unpub.LEXIS 7816 at *49, *51-52 (unpublished version) (finding that the "takings claims are unripe" and that the "writ proceeding does not address a decision by the Commission that sets a telephone company's rates after applying broadband imputation.").

[12] The Independent Small LECs are a group of small rural telephone companies: Calaveras Telephone Company, Cal-Ore Telephone Co., Ducor Telephone Company, Foresthill Telephone Co., Kerman Telephone Co., Pinnacles Telephone Co., The Ponderosa Telephone Co., Sierra Telephone Company, Inc., Siskiyou Telephone Company, and Volcano.

[13] This case has been docketed as California Supreme Court Case No. S278799.

[14] *Id.* at *53 ("[a]t this point, the 'total effect' . . . of broadband imputation on the telephone companies' rates cannot be determined because the Commission has not made the foregoing reasonableness determinations and established a telephone company's rate design and CHCF-A subsidy.").

[15] *Volcano Opening Comments on Proposed Decision* at 19:7-20:5.

abuse of discretion without any supporting findings.[16]

To avoid subjecting the Decision to judicial annulment, the Commission should: (1) remove Ordering Paragraph 3 from the Decision; (2) update the expense cap figures and Volcano's approved operating expenses for inflation through the 2023 test year; (3) recompute Volcano's income tax calculation based on longstanding Commission precedent and restore approximately $628,956 to the revenue requirement; and (4) remove the $1,592,174 in Volcano Vision's revenues from Volcano's rate design and increase Volcano's CHCF-A support for 2023 by that same amount. Even if the Commission does not immediately restore the $1,592,174 in wrongful CHCF-A reductions to Volcano, it should create a reasonable mechanism for reversing broadband imputation if and when a judicial determination is reached that the policy, or its application, are unlawful. The Commission should act expeditiously on this Application for Rehearing to avoid the material injuries that Volcano and Volcano Vision will experience from the legal errors identified herein.

II. RELEVANT FACTUAL AND PROCEDURAL BACKGROUND.

A. Procedural Events Leading to the Final Decision.

Volcano filed the Application that initiated this proceeding on November 1, 2021, in accordance with the 2015 rate case plan, the 2020 decision modifying the rate case plan, and the one-month extension of time authorized by the Commission's Executive Director.[17] Consistent with longstanding Commission precedent and the directives in D.20-08-011, Volcano used a 2023 test year to measure its costs and revenues and fashion a revenue requirement and rate design that would allow it to meet statutory and constitutional standards.[18] Cal Advocates protested the Application on December 1, 2021 and was the only other party to the proceeding.

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[16] *Decision* (reflecting no discussion of Volcano's Tier 2 advice letter proposal to update the results of the rate case if broadband imputation is found unlawful); *see* Pub. Util. Code §§ 1757(a)(3), (5); *City of Stockton v. Marina Towers LLC* (2009) 171 Cal.App.4th 93, 114 (finding that "[a] gross abuse of discretion occurs where the public agency acts arbitrarily or capriciously, [or] renders findings that are lacking in evidentiary support . . .").

[17] D.15-06-048, Appendix A (prescribing rate case cycle for the telephone companies); D.20-08-011 at 55, Appendix C (modifying rate case cycle); *July 26, 2021 Letter from Executive Director Peterson Granting Rule 16.6 Extension Request* (establishing Nov. 1, 2021 filing deadline).

[18] Pub. Util. Code §§ 275.6(c)(2), 275.6(b)(4); *Duquesne Light Co. v. Barasch* (1989) 488 U.S. 299, 308 ("If the rate does not afford sufficient compensation, the State has taken the use of utility property without paying just compensation."); *see also Federal Power Commission v. Hope Natural Gas Co.* (1944) 320 U.S. 591, 603; *Bluefield Water Works & Improvement Co. v. Pub. Service Comm'n of West Virginia* (1923) 262 U.S. 679, 690-693; U.S. Const., amends. V, XIV; Cal. Const., art. I, § 19.

The Commission determined the scope of the proceeding and established a procedural schedule in a Scoping Ruling issued on March 2, 2022.[19] Evidentiary hearings occurred from August 8, 2022 through August 10, 2022, during which the Commission accepted written, prepared direct testimony from the parties, heard live testimony on cross-examination and re-direct, and accepted other exhibits into the record. Briefing took place in September and October 2022, and a Proposed Decision was issued on December 30, 2022. Parties submitted comments on the Proposed Decision during January 2023. After the comment cycle was complete, a Revised Proposed Decision was issued on the eve of January 31, 2023.[20] The Revised Proposed Decision included additional language relating to the Commission's decision not to include the full range of custom calling features and voice mail options requested by the parties as part of the Commission's adopted significant rate hikes to Volcano's basic residential and business rates.[21] The Revised Proposed Decision also added a new Ordering Paragraph mandating "Volcano" to report to the Commission several broadband service quality metrics on an annual basis, but no findings or conclusions were added to support this last-minute addition.[22] The Revised Proposed Decision also modified Section 10 to note that the Commission had "reviewed the parties' comments, and where appropriate, revised the PD;"[23] however, other than briefly discussing Cal Advocates' comments relating to Cal Advocates' unopposed rate proposal, the Revised Proposed Decision did not address the parties' other comments on the Proposed Decision, including those subject to the instant Application, namely broadband service quality metrics and reporting requirements, the failure to adjust the expense caps and Volcano's operating expenses for the 2023 test year, the reduction of taxable income in response to broadband imputation, and the impact of the Commission's broadband imputation policy. The Revised Proposed Decision was

[19] *Assigned Commissioner's Scoping Memo and Ruling* at 5-7.
[20] While it is not included in the online docket of the proceeding, the Revised Proposed Decision is available here: http://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M501/K802/501802960.PDF.
[21] *Revised Proposed Decision* at 12-14, 40; *see also* Exh. PAO-3 (*Ahlstedt Testimony*) at 1-19:9-10 ("Custom Calling and Voice Mail features have tangible public safety implications for customers."); *Volcano Opening Brief* at 44-45 (reflecting Volcano's non-opposition to Cal Advocates' rate proposal given the associated public safety benefits).
[22] *Revised Proposed Decision* at 44 (O.P.3) ("Volcano Telephone Company is directed to submit its broadband service quality (SQ) metrics to the Communication Division on annual basis using a Tier 1 Advice Letter. The SQ metrics should include: (1) A total number of broadband service orders received and the number of those orders completed per month, during the previous 12 months; (2) Monthly broadband trouble tickets as a result of customer-initiated complaints on its broadband service in California, and (3) Annual broadband network unavailability due to service outages.").
[23] *Id.* at 40.

adopted without further revision as the final Decision at the Commission's voting meeting on February 2, 2023. It was formally issued on February 3, 2023.

B. Broadband Imputation and Its Implementation in Volcano's Rate Case.

As part of the CHCF-A rulemaking, the Commission adopted a policy termed "broadband imputation," which mandates a dollar-for-dollar reduction in "small independent telephone corporations'"[24] CHCF-A support in the amount of the positive net revenue that their ISP affiliates earn by providing Internet access service over the telephone companies' wireline networks within their service territories.[25] In effect, this policy incorporates ISP net revenue into telephone company rate design, even though the telephone company neither generates nor receives the broadband revenue; through this fiction, imputation creates systematic shortfalls for all CHCF-A recipients with profitable ISP affiliates. Broadband imputation applies to all CHCF-A recipients, but the Commission deferred implementation of the policy to each company's next rate case, including the instant case that is the subject of this Application for Rehearing.[26]

Volcano and the other "small independent telephone corporations" impacted by the broadband imputation policy filed a petition for writ of review before the Fifth District Court of Appeal to challenge the decisions requiring broadband imputation.[27] Each of the ISP affiliates, including Volcano Vision, joined the writ petition and the underlying application for rehearing.[28] The Court granted the petition, ordered the Commission to certify the record on appeal, and conducted oral argument on December 15, 2022.[29] On December 20, 2022, the Court rendered an unpublished Opinion upholding the broadband imputation policy against the petitioners' facial challenge on statutory and jurisdictional grounds, but the Court found that the petitioners' constitutional takings claims were "unripe" because the Commission had not yet implemented

[24] "Small independent telephone corporations" are defined in Public Utilities Code Section 275.6 to refer to "rural incumbent local exchange carriers subject to commission regulation."
[25] D.21-04-005 at 19, 23-24 (OP 1).
[26] *Id*. (OP 1) (deferring the implementation of broadband imputation to the next "general rate case" for Volcano and the other "Small ILEC[s].").
[27] The petition was filed on September 22, 2022 and docketed as Case No. F083339. As reflected in Volcano's January 31, 2022 Motion for Official Notice, the Court granted review on January 7, 2022. *See Volcano Motion for Official Notice*, Attachment A.
[28] *See* D.21-08-042 at 1 (noting that Volcano and Volcano Vision were both parties to the application for rehearing of D.21-04-005, which led to the Fifth District writ petition).
[29] *Id.,* Fifth District Court of Appeal, Case No. F083339; *see also Calaveras, et al.*, *supra*, 87 Cal.App.5th 793.

the imputation policy in telephone company rate cases.[30] One of the "real parties in interest," The Utility Reform Network ("TURN"), requested publication of the Opinion on January 9, 2023.[31] Separately, the petitioners sought rehearing to correct specific errors in the Court's Opinion.[32] In response to these requests, the Court ordered partial publication of the Opinion, focusing the published elements on the Court's statutory interpretation of Public Utilities Code Section 275.6.[33] The Court also ordered several corrections to the Opinion that correspond to petitioners' requested adjustments, although it formally denied rehearing.[34] The petitioners filed a Petition for Review with the California Supreme Court on February 27, 2023,[35] and other avenues to challenge the Opinion or the underlying broadband imputation policy remain open.

While the petitioners' writ challenge was pending, Volcano complied with the broadband imputation policy in its ratemaking calculations.[36] Its Application identified the net revenue derived from Volcano Vision's provision of Internet access service over Volcano's wireline network during 2020, which was the year prescribed by the broadband imputation decisions.[37] Volcano also left its revenue requirement unchanged, as the broadband imputation decisions require.[38] It implemented broadband imputation as a dollar-for-dollar reduction in its CHCF-A draw, and neither the Commission nor Cal Advocates contested the manner in which it

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[30] *See Calaveras, et al.*, *supra*, 2022 Cal.App.Unpub.LEXIS 7816 at *49-50 (unpublished version) ("At this point, the 'total effect' . . . of broadband imputation on the telephone companies' rates cannot be determined because the Commission has not made the foregoing reasonableness determinations and established a telephone company's rate design and CHCF-A subsidy. Consequently, we cannot determine that the rates will be so unreasonably low as to be confiscatory in violation of the telephone companies' constitutional rights.") (internal citations omitted).

[31] Fifth District Court of Appeal, Case No. F083339, *TURN Request for Publication* (Jan. 9, 2023).

[32] *Id.*, *Petitioners' Petition for Rehearing* (Jan. 4, 2023).

[33] *Id.*, *Order Modifying Opinion, Denying Rehearing and Granting Partial Publication* (Jan. 18, 2023).

[34] *Id.*

[35] *See* California Supreme Court Case No. S278799.

[36] *Application*, Exhibit B (providing all information necessary to compute broadband imputation adjustment, in the template supplied by Communications Division); *see also* D.21-04-005 at 24 (OP 2) (requiring "the Small ILEC" to "submit with its GRC Application a financial statement in a format to be provided by the California Public Utilities Commission Communications Division" to address broadband imputation.).

[37] *See Application* at 26:6-24; D.21-04-005 at 23 (OP 1) (the ISP revenue for imputation is the net revenue "or the calendar year immediately preceding the filing of the GRC application."); *see also* D.21-08-042 at 19.

[38] *See* D.21-04-005 at 18 ("we decline to consider ISP affiliate operations in the determination of the Small ILECs' revenue requirements.").

performed this calculation.[39] However, Volcano maintained its legal position that the imputation policy is unlawful, and it requested in its Application, its opening brief, and its comments on the proposed decision for the Commission to create a procedural vehicle to reverse broadband imputation,[40] should a reviewing court agree with Volcano's and Volcano Vision's position that the imputation policy is contrary to law.

The Commission adopted the $1,592,174 broadband imputation figure identified by Volcano, which Cal Advocates did not oppose.[41] The Commission also adopted a tax calculation that acknowledges the shortfall created by broadband imputation, noting that "if taxes are estimated on a CHCF-A draw that is calculated before broadband revenues are imputed, tax liability will be overstated."[42] In addition, the Commission failed to address Volcano's request to create a vehicle to reverse broadband imputation in response to a successful appeal.[43] Based on the final Decision, Volcano's forecasted revenues from regulated telephone operations are $9,206,788 and its regulated costs, as manifested in revenue requirement, are $10,798,962,[44] resulting in a revenue shortfall of $1,592,174—the exact amount of the broadband imputation.[45]

III. STANDARD OF REVIEW AND SUMMARY OF LEGAL ERRORS.

The standard of review for this Decision is set forth in Public Utilities Code Section 1757, which provides the grounds under which Commission ratemaking decisions are subject to annulment.[46] The Decision commits the following legal errors under this statutory standard:

1. The Decision's imposition of broadband service quality tracking and reporting requirements on Volcano relating to Volcano Vision's broadband service quality exceeds the scope of Volcano's rate case and the Commission's jurisdiction, is unsupported by the Decision's findings and substantial record evidence, constitutes

[39] *Decision*, Appendix A at A-1, Line 1(b); *see also* Exh. PAO-03-C (*Ahlstedt Opening Testimony*) at 2-38:15-17 (confirming agreement on broadband imputation figure).
[40] *Application* at 3 (n.9), 4 (n.11), 26:6-13; *Volcano Opening Brief* at 47, 63-64; *Volcano Opening Comments on Proposed Decision* at 18:22-20:5.
[41] *Decision*, Appendix A at A-1, Line 1.b. The broadband imputation policy has no apparatus for addressing this disconnect or updating imputation figures for forward-looking impacts. *See* D.21-04-005 at 24 (OP 1) (the financials that inform the broadband imputation adjustment must be calculated using the net revenue "for the calendar year immediately preceding the filing of the GRC application.").
[42] *Decision* at 26.
[43] *Compare Volcano Opening Comments on Proposed Decision* at 19:7-20:5 (requesting that the Commission "incorporate a mechanism in the Proposed Decision to reverse broadband imputation if it is ultimately deemed unlawful.") to *Decision* (making no mention of Volcano's proposed mechanism to reverse imputation).
[44] *Decision*, Appendix A at A-1, A-2, Lines 1.a, 7.
[45] *Id.*, Appendix A at A-1, Line 1.b.
[46] Pub. Util. Code § 1757 (addressing the standard of review for Commission ratemaking decisions).

an abuse of discretion, and violates Volcano's and Volcano Vision's constitutional rights to due process and equal protection.[47]

2. The Decision's failure to adjust the applicable expense caps and Volcano's operating expenses for the 2023 test year unjustifiably departs from Commission precedent, is unsupported by the Decision's findings and substantial record evidence and constitutes an abuse of discretion.[48]

3. The Decision's reduction of taxable income in response to broadband imputation violates express Commission directives, unjustifiably departs from Commission precedent, is unsupported by the Decision's findings and substantial record evidence and constitutes an abuse of discretion.[49]

4. By implementing broadband imputation, the Decision creates a shortfall between Volcano's regulated costs and its regulated revenues, effectuating a taking of utility property.[50] If, alternatively, the shortfall is attributed to Volcano Vision, it results in a 100% confiscation of Volcano Vision's profits.[51] Either way, this result constitutes a failure to "proceed[] in the manner required by law, a violation of Volcano's and/or Volcano Vision's constitutional rights, an action in excess of the Commission's jurisdiction, and an abuse of discretion.[52]

5. By failing to incorporate a vehicle to reverse broadband imputation if it is deemed unlawful, the Decision effectuates an abuse of discretion and reaches a result that is "not supported by the findings."[53]

Individually and collectively, these errors inflict material injuries on Volcano and/or Volcano Vision. Rehearing must be granted to facilitate appropriate adjustments and clarifications into the Decision, which is unlawful and subject to annulment through a petition for writ of review.

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[47] Pub. Util. Code §§ 1757(a)(1), (2), (3), (4), (5), (6); *see also* U.S. Const., Amend. XIV; Cal. Const. art. I, § 7(a) ("A person may not be deprived of life, liberty, or property without due process of law or denied equal protection of the laws.").
[48] Pub. Util. Code §§ 1757(a)(2), (3), (4), (5).
[49] *Id.*
[50] *See* U.S. Const., amends. V, XIV; Cal. Const., art. I, § 19; *Duquesne*, *supra*, 488 U.S. at 308; *Hope*, *supra*, 320 U.S. at 603; *Bluefield*, *supra*, 262 U.S. at 690-693; *see also Brooks-Scanlon, supra*, 251 U.S. at 399 (reversing a state commission ratemaking calculation that relied on non-regulated revenue to depict the profitability of utility operations).
[51] *Ponderosa v. Pub. Util. Comm'n* (2011) 197 Cal.App.4th 48, 59-60 (seizure of returns on unregulated investments unconstitutional); *Brown v. Legal Foundation of Washington* (2003) 538 U.S. 216, 233-235 (transfer of interest on client trust accounts to government accounts constituted a "per se" taking, not judged according to a utility ratemaking takings standard).
[52] Pub. Util. Code §§ 1757 (a)(1), (2), (5), (6).
[53] Pub. Util. Code §§ 1757 (a)(3), (5).

IV. THE DECISION'S IMPOSITION OF ONEROUS BROADBAND SERVICE QUALITY TRACKING AND REPORTING REQUIREMENTS ON VOLCANO AND VOLCANO'S UNREGULATED ISP AFFILIATE EXCEEDS THE SCOPE OF VOLCANO'S RATE CASE AND THE COMMISSION'S JURISDICTION, IS UNSUPPORTED BY ITS FINDINGS AND SUBSTANTIAL RECORD EVIDENCE, AND CONSTITUTES AN ABUSE OF DISCRETION.

Ordering Paragraph 3 of the Decision was added to the Proposed Decision just two business days before the Commission's voting meeting and the parties had no opportunity to comment on this new Ordering Paragraph, which contains multiple material legal errors. As an initial matter, Ordering Paragraph 3 incorrectly directs "Volcano Telephone Company" to submit "its broadband service quality (SQ) metrics" to the Communications Division on an annual basis even though the record clearly shows that Volcano does not provide any retail broadband services. Rather, Volcano Vision provides retail broadband services to portions of Volcano's service area and areas outside of Volcano's service territory; only Volcano Vision's broadband services *in Volcano's service area* rely on Volcano's local exchange network.[54] Although this Ordering Paragraph should be removed altogether for the reasons explained in this section, if it improperly remains, it must be corrected to avoid confusion[55] and correctly refer to Volcano Vision, not Volcano. In addition, this paragraph should be further revised to limit the mandated broadband service quality metrics and reporting requirements to Volcano Vision's retail broadband services in Volcano's service territory that rely on Volcano's network through the purchase of tariffed wholesale Digital Subscriber Line ("DSL") transmission service from Volcano; metrics relating to Volcano Vision's retail broadband services outside of Volcano's service territory that rely on alternative service platforms are unrelated to the functionality and

[54] *See* Exh. VTC-04 (*Lundgren Opening Testimony*) at 2 ("Volcano Vision, Inc. ('Volcano Vision') provides video and Internet access services to portions of Volcano's certificated service territory and outside of Volcano's telephone service territory in other parts of Calaveras, Amador, and Alpine Counties. In Volcano's territory, this Internet access service is enabled through Volcano Vision's purchase of wholesale DSL service from Volcano through the National Exchange Carrier Association ('NECA') FCC Tariff No. 5."); Exh. VTC-05 (*Lundgren Rebuttal Testimony*) at 4:22-24 ("Volcano is not an ISP; it is a network provider and must ensure that its network has sufficient broadband capabilities, regardless of how Volcano Vision delivers retail services over that network."), 9:8 (Volcano does not provide [retail] broadband services, contrary to Mr. Corona's characterization."); *Application* at 26, n. 23 ("Volcano Vision also provides broadband services outside of Volcano's telephone service territory, but these services are based on alternative platforms that do not utilize Volcano's local loop facilities."); *Application*, Exh. B ("Vision provides internet service over fiber, fixed wireless and cable modem outside of the telco service area.").

[55] Because Volcano only provides wholesale DSL broadband service, this paragraph could be referring to Volcano's wholesale service rather than Volcano Vision's retail service.

sufficiency of Volcano's facilities. Cal Advocates' testimony relating to broadband service quality metrics claimed they were needed to assess the "service quality customers experience on broadband services received over Volcano's broadband-capable network" "for customers in Volcano's service territory."[56] These clear errors in Ordering Paragraph 3 exceed the Commission's jurisdiction and scope of this proceeding, are unsupported by the Decision's findings and substantial record evidence, and constitute an abuse of discretion.[57] They also violate Volcano's and Volcano Vision's procedural due process rights because they had no notice that this proceeding would include the consideration of broadband service quality reporting requirements relating to Volcano Vision's services outside of Volcano's service area.[58]

Even with these revisions, Ordering Paragraph 3 would still exceed the scope of Volcano's rate case because the Scoping Memo does not include the adoption of any new reporting requirements concerning Volcano's unregulated ISP affiliate. The only scoping issue that even references "broadband services" is Scoping Memo issue "g," which asks: "Are the proposed plant improvements necessary for providing safe, reliable, and high-quality voice and broadband services?"[59] This issue, however, is limited to an evaluation of Volcano's proposed test year plant investments and does not include the consideration of ongoing broadband service quality reporting requirements by Volcano Vision. Rather, the consideration of regular broadband service quality metrics and reporting requirements is within the scope of the Commission's pending industrywide service quality metrics, where the applicable scoping memo provides that Phase 2 will address:

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[56] Exh. PAO-05 (*Corona Testimony*) at 2-1:18 to 2-2:1, 2-3:16-18; *see also id.* at 2-1:13-14 (referring to Volcano's service territory customers).
[57] Pub. Util. Code §§ 1757(a) (1)-(5).
[58] Pub. Util. Code §§ 1757(a)(6); *see also Scoping Memo* at 5-6; 20 CCR § 7.3; *Southern California Edison Co. v. Pub. Utilities Comm'n* (2006) 140 Cal.App.4th 1085, 1094 (annulling a Commission decision that addressed subject matters beyond the terms of the Scoping Memo, finding that the Commission failed to proceed in the manner required by law when it violated its own rules by reaching conclusions on issues that exceed the defined scope of the proceeding); *People v. Western Airlines, Inc.* (1954) 42 Cal.2d 621, 632 ("Due process as to the commission's initial action is provided by the requirement of adequate notice to a party affected and an opportunity to be heard before a valid order can be made."); *Pacific Gas & Electric Co. v. Pub. Util. Comm'n* (2015) 237 Cal.App.4th 812, 860 ("'An elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.'") (*quoting Mullane v. Central Hanover Tr. Co.* (1950) 339 U.S. 306, 314).
[59] *Decision* at 6; *Scoping Memo* at 6.

1. Should the Commission adopt service quality metrics and standards and reporting requirements applicable to broadband Internet service?

2. If yes, what specific service quality metrics and standards, reporting requirements, and enforcement framework should the Commission adopt?[60]

Commission Rule 7.3 requires that the Scoping Memo "shall determine . . . issues to be addressed," in Commission proceedings.[61] Because the Decision's adoption of reporting requirements for Volcano Vision's broadband service quality exceeds the scope of the Decision, the Decision fails to proceed in the manner required by the Commission's own rules and the Public Utilities Code and is subject to annulment.[62] It further violates Volcano's and Volcano Vision's constitutional due process rights to fair notice.[63]

Ordering Paragraph 3 also unjustifiably departs from Commission precedent and constitutes an abuse of discretion.[64] In Sierra's test year 2023 rate case, Cal Advocates proposed the same broadband service quality reporting requirements it advanced in Volcano's test year 2023 rate case,[65] and the Sierra decision contains a nearly identical Section 7.2.1 discussing the parties' discovery dispute regarding broadband service quality. The Commission declined to

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[60] R.22-03-016, *Scoping Memo* at 3; *see also* R.22-03-016, *Order Instituting Rulemaking* at 16-17 (initiating review of service quality rules in Commission General Order ("G.O.") 133-D, including consideration of whether standards should be "applicable to broadband service").
[61] *See also* Pub. Util. Code § 1701.1(b)(1).
[62] *See* Pub. Util. Code § 1701.1(b)(1); 20 CCR § 7.3; *Southern California Edison*, *supra*, 140 Cal.App.4th 1085; Pub. Util. Code §1757(a)(2); *see also Calaveras Telephone Company v. Pub. Util. Comm'n* (2019) 39 Cal App.5th 972 (annulling Commission resolution on the ground that the Commission abused its discretion by failing to follow its own rules); *Southern Cal. Edison Co. v. Pub. Util. Comm'n* (2000) 85 Cal.App.4th 1090, 1105 (annulling decision and resolution based on conflict with the requirements of a preexisting Commission General Order); *Cal. Motor Transp. Co. v. Pub. Util. Comm'n* (1963) 59 Cal.2d 270, 272 ("'all hearings, investigations, and proceedings' are governed by sections 1701 through 1709'") (*quoting* Pub. Util. Code § 1701).
[63] Pub. Util. Code § 1757(a)(6); *see also* U.S. Const., Amend. XIV; Cal. Const. art. I, § 7(a).
[64] Pub. Util. Code §§ 1757(a)(2), (5); *see also Woodbury v. Brown-Dempsey* (2003) 108 Cal.App.4th 421, 438 (If an agency's interpretation of a law or rule is "arbitrary and capricious," that action is an abuse of discretion); *see also City of Stockton v. Marina Towers LLC* (2009) 171 Cal.App.4th 93, 114 (finding that "[a] gross abuse of discretion occurs where the public agency acts arbitrarily or capriciously, [or] renders findings that are lacking in evidentiary support . . ."); *Zuehlsdorf v. Simi Valley Unified Sch. Dist.* (2007) 148 Cal.App.4th 249, 256 (actions "not supported by a fair or substantial reason" are also arbitrary and capricious). An agency's departure from its own precedent without adequate explanation is arbitrary and capricious. *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.* (1983) 463 U.S. 29, 42; *McPherson v. Pub. Employment Relations Bd.* (1987) 189 Cal.App.3d 293, 308-309, 311.
[65] Exh. PAO-5 (Corona Testimony) at 5:17-25, Attachment B; A.21-11-005, Exh. PAO-5 (Corona Testimony) at 4:4-10, Attachment B.

adopt broadband service quality reporting requirements in Sierra's rate case.[66] Similarly, in the test year 2019 Foresthill and Ducor rate cases, the most recent cases prior to Sierra's and Volcano's cases, Cal Advocates urged the Commission to adopt broadband service quality reporting requirements, and the Commission rejected this proposal as to both companies.[67] The Commission likewise imposed no such requirement in Phase 2 of the CHCF-A rulemaking in response to the Fourth Amended Scoping Memo, which inquired: "Should the Commission adopt broadband service measures or obligations on the Small RLECs as a condition of § 275.6(c)(6)?"[68] The Decision arbitrarily and capriciously departs from these Commission precedents for similarly situated rural, small independent telephone corporations in adopting broadband service quality reporting requirements in Volcano's individual rate case proceeding.

The Commission's unjustifiable departure from Commission precedent is particularly improper, discriminatory, and harmful to Volcano and Volcano Vision given the pending industrywide rulemaking to consider broadband service quality metrics and reporting requirements.[69] In addition to conflicting with Commission precedents, the Decision's imposition of rules on Volcano and Volcano Vision outside a quasi-legislative or rulemaking proceeding violates well-established Commission procedural rules.[70] Moreover, the Decision mandates disparate regulatory treatment of Volcano and its ISP affiliate relative to other

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[66] D.23-01-004 at 42-45.

[67] *See* D.19-06-025 at 26-27 (summarizing Cal Advocates' broadband service quality proposed reporting requirements), 28 ("We decline to adopt Cal Advocates recommendation to require Ducor to retain and report information on all service outages lasting at least 30 minutes" and "[w]e decline to adopt the remainder of Cal Advocates service quality recommendations because they are more appropriately considered in the ongoing second phase of R.11-11-007"); *accord* D.19-04-017 at 61-63 (declining to adopt unilateral service quality requirements for Foresthill, citing G.O. 133-D and the CHCF-A rulemaking).

[68] *See* D.21-06-004 at 43-44 (adopting broadband imputation and miscellaneous revenue reporting requirements in rate cases but enacting no annual reports or broadband service quality reports); R.11-11-007, *Fourth Amended Scoping Memo* at p.5, Issue 2.1(1)(f)(i)-(ii); TURN-1 (*Roycroft Opening Testimony*) at 73-74 (recommending the Commission "adopt broadband service measures or obligations as a condition of § 275.6(c)(6).").

[69] *See also Volcano Reply Brief* at 28-32.

[70] *Compare* Pub. Util. Code § 1701.1(d)(1) (confirming focus of "quasi-legislative" proceedings on "establish[ing] policy, including, but not limited to, rulemakings and investigations which may establish rules affecting an entire industry"); Pub. Util. Code § 1701.1(d)(3) (defining "ratesetting" proceedings as those in which rates are established for a specific company, including, but not limited to, general rate cases . . . ."); *see also* CPUC Rules 1.3(f), 1.3(g).

similarly situated network providers and ISPs, which violates Volcano's and Volcano Vision's constitutional rights to equal protection of the laws.[71]

The imposition of onerous broadband service quality metrics and reporting requirements on Volcano's ISP affiliate—an unregulated entity providing interstate, unregulated broadband services—also exceeds the Commission's jurisdiction.[72] The Commission has no jurisdiction over ISP affiliates, as they are neither "telephone corporations" nor otherwise included in the definition of "public utility."[73] To be a "telephone corporation," a corporation must "own, control, operate, or manage" a "telephone line," and Volcano's ISP affiliate is not engaged in any of these activities.[74] Moreover, even if the Commission had statutory authority under state law to regulate broadband services as public utility services—which it does not—the Commission may not act in ways that conflict with or undermine federal law and regulations.[75] Internet access service is an information service subject to the FCC's authority and beyond the Commission's regulatory purview.[76] As the FCC has found, "it is well-settled that Internet access is a jurisdictionally interstate service because a substantial portion of Internet traffic involves accessing interstate or foreign websites."[77] Based on those interstate characteristics, the classification of broadband service is within the FCC's regulatory authority, not the Commission's jurisdiction.[78] Information services are subject to a deregulatory framework in

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[71] *See, e.g.*, *Walgreen Co. v. City & Cty. of San Francisco* (2010) 185 Cal.App.4th 424, 443–44 (finding complaint stated valid basis for equal protection violation where the City failed to identify a sufficient rationale for applying the regulation only to certain stores and not others); Cal. Const. art. I, § 7(a) ("A person may not be deprived of life, liberty, or property without due process of law or denied equal protection of the laws."); *see also In the Matter of Petition of NTCA—The Rural Broadband Association and the United States Telecom Association for Forbearance et al.*, WC Docket No. 17-206, *Order,* FCC 18-75 (rel. June 8, 2018) at ¶15 ("By forbearing from application of USF contribution requirements to rural LEC-provided broadband Internet access transmission services, we eliminate the disparate treatment of these services and level the playing field to allow rural LECs to compete more effectively with other broadband providers."); Pub. Util. Code § 1757(a)(6).

[72] Pub. Util. Code § 1757(a)(1).

[73] Pub. Util. Code §§ 216 (definition of "public utility"), 234 (definition of "telephone corporation").

[74] Pub. Util. Code § 234.

[75] *Geier*, *supra*, 529 U.S. at 873-874.

[76] *See RIFO* at ¶ 20 ("[w]e reinstate the information service classification of broadband Internet access service."); *see also* Pub. Util. Code § 202 (prohibiting Commission jurisdiction over "interstate commerce" except as permitted under federal law).

[77] *RIFO* at ¶ 199; *United States v. Costanzo* (9th Cir. 2020) 956 F.3d 1088, 1092 (internal quotation marks and citation omitted).

[78] 47 U.S.C. § 152(a); Pub. Util. Code §§ 216, 233, 234; Cal. Const., art. XII, §§ 3 (defining public utilities that are "subject to control by the Legislature"), 6 (the CPUC "may fix rates establish rules,

which "public-utility style" or "common carrier" regulations are not permitted.[79] Ordering Paragraph 3 subjects unregulated, interstate broadband services to "common carrier" service quality regulations, which triggers federal preemption.[80] Not only would the Decision's mandated broadband service quality metrics and reporting requirements be conflict preempted because they would impose traditional "common carrier" regulation on information service providers,[81] but they would also conflict with the more limited broadband availability and demand data collection that the FCC has deemed appropriate, such as the Broadband Data Collection submissions and the FCC's Connect America Fund performance standard data.[82] The imposition of burdensome service quality regulations on unregulated, interstate information

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examine records, . . . for all *public utilities* subject to its jurisdiction.") (emphasis added); *see also City & Cty. of San Francisco v. W. Air Lines, Inc.* (1962) 204 Cal.App.2d 105, 131 ("Unless the enterprise or activity in question is a public utility as defined in the Constitution or Public Utilities Code, it is not subject to the jurisdiction of such commission."), *citing Television Transmission v. Pub. Util. Comm'n.* (1956) 47 Cal.2d 82, 84.

[79] *RIFO* at ¶ 87 ("[W]e conclude that economic theory, empirical studies, and observational evidence support reclassification of broadband Internet access service as an information service rather than the application of public-utility style regulation on ISPs. We find the Title II classification likely has resulted, and will result, in considerable social cost, in terms of foregone investment and innovation.").

[80] *See, e.g.*, *Telecommunications Ass'n v. Brand X Internet Servs.* ("Brand X") (2005) 545 U.S. 967, 975 ("The [Telecommunications] Act regulates telecommunications carriers, but not information-service providers, as common carriers."); *Fischer v. Time Warner Cable Inc.* (2015) 234 Cal.App.4th 784, 791 ("A federal agency's regulations will preempt any state or local laws that conflict with or frustrate the regulations' purpose."); *Charter Advanced Servs. (MN), LLC v. Lange* (8th Cir. 2018) 903 F.3d 715, 718 ("any state regulation of an information service," such as broadband services, "conflicts with the federal policy of nonregulation" and is preempted); *see also Geier, supra,* 529 U.S. at 873-874; *N.Y. State Telecomms. Ass'n v. James* (E.D.N.Y. 2021) 544 F.Supp.3d 269, 281 ("In reclassifying broadband internet as a Title I information service, the FCC made the affirmative decision not to treat it as a common carrier.").

[81] The Ninth Circuit rejected preemption arguments based on Section 153(51) of the Telecommunications Act in the context of an interlocutory appeal from the denial of a preliminary injunction in a case challenging a California "net neutrality" statute. *ACA Connects – America's Communications Assoc. v. Bonta* (9th Cir. 2022) 24 F.4th 1233. This ruling reflects divergence from both D.C. Circuit and Eighth Circuit precedent concerning conflict preemption. *See Charter*, *supra*, 903 F.3d 715; *Minn. Pub. Utils. Comm'n v. FCC* (8th Cir. 2007) 483 F.3d 570, 580. The Ninth Circuit construed the D.C. Circuit's decision in *Mozilla*, *supra*, 940 F.3d 1, to hold that the FCC's 2018 order classifying broadband as an information service had no conflict preemptive effect. However, when the dissenting judge in *Mozilla* claimed that the majority's opinion would obviate conflict preemption—referring to California's net neutrality law as an example of the type of law states could enact, *see id.* at 95—the majority called his concern a "straw man" and "confuse[d]." *Id.* at 85.

[82] *See Establishing the Digital Opportunity Data Collection; Modernizing the FCC Form 477 Data Program*, WC Docket Nos. 19-195, 11-10, Order, FCC 22-93 (rel. Dec. 9, 2022); *In re: Connect America Fund*, WC Docket No. 10-90, *Performance Metrics Order*, DA 18-710 (rel. July 6, 2018), *Order on Reconsideration*, FCC 19-104 (rel. Oct. 31, 2019); *Performance Measures Clarification Order*, DA 20-1510 at ¶1 (rel. Dec. 18, 2020).

services would also harm consumers by stifling innovation and investment in these services in contradiction of the FCC's findings supporting its "information services" designation of broadband services.[83]

These FCC findings, which the *Mozilla* court did not overturn, included the "effects [of public utility style regulation] on small ISPs and rural communities where firms are more likely to take the risks of offering much-needed services in a more predictable and less onerous regulatory climate."[84] The imposition of burdensome broadband service quality metrics and reporting requirements stands as an obstacle to this federal deregulatory policy and the underlying purpose of the FCC's reclassification of broadband services as information services.[85] The record shows that the broadband service quality metrics and reporting requirements in Ordering Paragraph 3 would impose significant costs and burdens on Volcano and/or Volcano Vision,[86] and expert testimony shows that additional operating expenses should be added to Volcano's revenue requirement to ensure recovery of regulatory costs associated with any broadband service quality metrics.[87] Yet, the Decision arbitrarily and capriciously adopts onerous broadband service quality metrics without addressing these significant costs and burdens or providing any vehicle for Volcano or Volcano Vision to recover them.

The Decision does not contain any findings that support the imposition of onerous broadband service quality metrics and reporting requirements on Volcano and/or Volcano

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[83] *RIFO* at ¶ 1 (finding that "burdensome regulation . . . stifles innovation and deters investment."); *see also In the Matter of Restoring Internet Freedom; Bridging the Digital Divide for Low-Income Consumers; Lifeline and Link Up Reform and Modernization*, WC Docket Nos. 17-108, 17-287 & 11-42, *Order*, FCC 20-151 (rel. Oct. 29, 2020) ("*RIFO on Remand*") at ¶ 5 (reiterating that "economic theory, empirical data, and experience counseled in favor of ending utility-style regulation of ISPs" and that information service classification "would be particularly beneficial to rural and/or lower-income communities, removing excessive regulatory and compliance burdens and, as a result, giving smaller ISPs a stronger business case to expand into currently underserved areas."); *see also N.Y. State Telecomms. Assoc.*, *supra*, 544 F.Supp.3d at 282 (finding "common carrier obligations directly contravene[] the FCC's determination that broadband internet 'investment,' 'innovation,' and 'availab[ility]' best obtains in a regulatory environment free of threat of common-carrier treatment, including its attendant rate regulation.").

[84] *Mozilla, supra*, 940 F.3d at 50 (citing *RIFO* at ¶¶ 103-106).

[85] *RIFO* at ¶ 1; *see also RIFO on Remand* at ¶ 5; *Chamber of Commerce of US et. al. v. Bonta* (9th Cir. 2023) 2023 U.S. App. LEXIS 3586, *28 ("Because the FAA's purpose is to further Congress's policy of encouraging arbitration, and AB 51 stands as an obstacle to that purpose, AB 51 is therefore preempted.").

[86] Exh VTC-05 (*Lundgren Rebuttal Testimony*) at 18:7-9, 19:14-16.

[87] Exh. VTC-07 (*Duval Rebuttal Testimony*) at 3:18-21.

Vision.[88] Section 7.2.1 is entitled "Relevance of Retail Broadband Revenues and Quality and Reliability of Broadband Services to CHCF-A."[89] This section, however, only addresses the Administrative Law Judge's ("ALJ") resolution of Cal Advocates' motion to compel data request responses concerning broadband service quality during the underlying rate case proceeding; it does not address ongoing broadband service quality tracking and reporting requirements.[90]

In addition, annual broadband service quality tracking and reporting requirements are unsupported by substantial record evidence.[91] The Decision fails to cite to any record evidence to support the imposition of annual broadband service quality tracking and reporting requirements. While Cal Advocates proposed broadband service quality metrics and reporting requirements, its testimony failed to show that broadband installation commitment and trouble report metrics are relevant to analyzing Volcano's proposed test year 2023 plant investments or Volcano's network quality and reliability.[92] As Mr. Lundgren's testimony shows, the "broadband installation commitments" reflect the "percentage of commitments met as a function of the total number of service requests," and the failure to meet an installation commitment would generally be caused by situations unrelated to Volcano's network, such as "an emergency, accessibility to the property, staffing issues, or other unique situations that prevent Volcano Vision from physically connecting the customer."[93] Similarly, trouble reports measure "dissatisfaction about 'service affecting' problems with a customer's service, including 'out of service' issues."[94] Trouble reports often relate to issues unrelated to the functionality of Volcano's network, such as "Volcano Vision-provided or customer modems, synchronization failures caused by Volcano Vision's equipment, errors in Volcano Vision's installation process, wireless interference issues or wiring issues inside the home."[95] While trouble reports may theoretically implicate Volcano's network in limited circumstances where they happen to raise

[88] *Decision* at 41-42; *see also* Pub. Util. Code § 1757(a)(3).
[89] *Decision* at 33.
[90] *Id.* at 33-36.
[91] Pub. Util. Code § 1757(a)(4).
[92] *See* Exh. PAO-5 (*Corona Testimony*) at 2-3:9-2-4:18 (making conclusory assertions that without these metrics the Commission has an "incomplete assessment on the quality, reliability, and safety of Volcano's broadband services," even though Volcano Vision, not Volcano is the entity providing retail broadband services).
[93] Exh. VTC-05 (*Lundgren Rebuttal Testimony*) at 9:24-10:3.
[94] *Id.* at 10:4-5.
[95] *Id.* at 10:6-10.

questions about network adequacy, they do not directly measure the functionality of Volcano's network and are unrelated to the need for Volcano's test year broadband-capable investments.[96] These broadband service reporting requirements are irrelevant to evaluating whether Volcano's "plant improvements are necessary for providing safe, reliable, and high quality voice and broadband services?"[97] Moreover, "Volcano Vision's costs are not included in Volcano's revenue requirement or rate base."[98] Even if the Commission believes that the reporting of these broadband service quality metrics or "broadband network unavailability" are needed in the context of rate cases to assess Volcano's proposed plant investments, substantial record evidence does not support annual reporting requirements.

V. THE DECISION'S FAILURE TO ADJUST THE APPLICABLE EXPENSE CAPS AND VOLCANO'S OPERATING EXPENSES FOR THE TEST YEAR UNJUSTIFIABLY DEPARTS FROM COMMISSION PRECEDENT, IS UNSUPPORTED BY THE DECISION'S FINDINGS AND SUBSTANTIAL RECORD EVIDENCE AND CONSTITUTES AN ABUSE OF DISCRETION.

The Decision's adopted expense caps and operating expense figure fail to account for the full impacts of inflation through the end of the 2023 test year.[99] This material calculation error fails to proceed in the manner required by the Commission's longstanding test year ratemaking tenets.[100] The Commission's adopted inflation factors reflect arbitrary and capricious decision-making that unjustifiably departs from these test year ratemaking tenets, and is inconsistent with the 2015 rate case plan, as updated through D.20-08-011,[101] applicable federal regulations,[102] and National Exchange Carrier Association, Inc.'s ("NECA") express guidance regarding the vintage

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[96] *Id.* at 10:10-17.
[97] *Scoping Ruling* at 6 (Issue g).
[98] Exh. VTC-05 (*Lundgren Rebuttal Testimony*) at 9:12-13.
[99] *See Decision* at 20; *see also Decision* at 42 (FOF 9, COL 3), 43 (OP 1(c)).
[100] *See City of Los Angeles v. Pub. Util. Comm'n* (1972) 7 Cal.3d 331, 346 ("The basic approach of the commission in rate making . . . is to take a test year and determine the revenues, expenses, and investment for the test year."); *see also Ponderosa*, *supra*, 197 Cal.App.4th at 51 ("the Commission examines the company's costs in a test year and determines the company's revenue requirement during that test year"); D.04-06-018 at 6 (a "test year" is "the period over which the cost of service and the proposed rates will be evaluated.").
[101] *See* D.15-06-048, Appendix A (establishing rate case cycle and confirming the use of future test years for measuring results of operations); D.20-08-011, Appendix C (prescribing 2023 test year for Volcano's rate case).
[102] *See* 47 C.F.R. § 54.1308(a)(4)(i)-(ii) (comparing "actual monthly per-loop Corporate Operations expense" to the "monthly per-loop amount computed" by the corporate expense formula in Section 54.1308(a)(4)(ii)(A)); 47 C.F.R. § 54.1305 (designating the vintage of the company data for comparison as derived from "the calendar year preceding each July 31 filing"); 47 C.F.R. § 54.303(a)(6) (confirming operation of inflation in operating expense limitation formula).

of its inflation factors.[103] The failure to account for inflation through the test year for the expense caps and Volcano's operating expenses is also divorced from substantial record evidence and the Decision's findings.[104]

Because the expense caps are derived from the federal high-cost support paradigm, which relies on historical expense data,[105] the most current inflation factors available at any given time only measure the effects of inflation through the end of the prior calendar year, which is two years prior to the year in which federal high-cost support is being established.[106] Thus, the inflation factor released by NECA in October 2021 only encompassed inflationary effects through the end of 2020, and this inflation factor was used to calculate 2022 high-cost support.[107] In contrast to this federal support mechanism, the Commission's longstanding "test year ratemaking" calculations focus on a defined future "test year."[108] Pursuant to the Commission's "rate case plan," the Commission uses the second full year after the rate case filing as the "test

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[103] *See Volcano Motion to Reopen the Record* (Dec. 12, 2022), Attachment 1 (confirming that 1.3% GDP-CPI increase in NECA's 2021 USF Data Submission reflects "the price increase for costs incurred in 2019 vs. costs incurred in 2020, and is not a projection of inflation for 2022"); Pub Util. Code §§ 1757(a)(2), (5); *Motor Vehicle Mfrs. Ass'n*, *supra*, 463 U.S. at 42; *McPherson*, *supra*, 189 Cal.App.3d at 308-309.

[104] *See Volcano Reply Brief*, Appendix A, Line 2 (comparing Volcano's and Cal Advocates' expense proposals); Exh. PAO-2 (*Exhibits to Ye Testimony*), Exhibit C-1, Attachment 1, Line 8 (depicting the 1.3% GDP-CPI increase as a measurement of the "Change in GDP-CPI 2020"); Exh. VTC-07 (*Duval Rebuttal Testimony*) at 9:6-8 (". . . the inflation factor released in October 2021 is designed to allow for an 'apples to apples' comparison between the 2020 results of the cap and each company's 2020 actual expenses. It does not account for inflation during 2021, 2022, or 2023."); Pub. Util. Code § 1757(a)(3)-(4); *Decision* at 41-42. The Decision includes the conclusory finding "[i]t is appropriate to apply NECA's most recent inflation factors to adjust Volcano's proposed corporate operations expenses of $9,142,185 to $8,226,431;" however, this finding does not show that the use of NECA's most recent inflation factors appropriately adjusts the corporate operations expense cap to the 2023 test year as required by test year ratemaking. *Decision* at 42 (FOF 9).

[105] 47 C.F.R. § 54.1305(f) (confirming that corporate expense data submitted to NECA in "each July 31st filing" is derived from "the calendar year preceding" that submission); 47 C.F.R. § 54.303(a)(4) (total eligible annual operating expenses for 2016 will be limited to the total eligible annual operating expenses as defined in this section").

[106] Exh. VTC-07 (*Duval Rebuttal Testimony*) at 9:2-4 (". . . the 2020 GDP-CPI factor that was published by NECA in 2021 is used to update the corporate cap to reflect inflation between 2019 and 2020 so that it can be applied in calculating support paid two years later, in 2022"); *RT* at 221:2-5 (Ye) (agreeing that "NECA doesn't offer projections for future time periods.").

[107] *See* Exh. PAO-02 (*Exhibits to Ye Testimony*), Exhibit C-1, Attachment 1, Line 8 (inflation factor issued in 2021 reflects "Change in GDP-CPI 2020"); *Volcano Motion to Reopen the Record* (Dec. 12, 2022), Attachment 1 (confirming that 2021 NECA letter does not contain a "projection of inflation for 2022.").

[108] *See* D.04-06-018 at 6 (defining a "test year" as "the period over which the cost of service and the proposed rates will be evaluated."); *City of Los Angeles*, *supra*, 7 Cal.3d at 346.

year."[109] The development of cost and revenue data for a future test year often relies on historical information as a starting point, but it must be updated and projected to reflect the likely results of operations in the test year.[110] To comply with test year ratemaking, the Commission must apply projections of inflation for each of the years from the base year used by NECA to the future test year used in a rate case.[111] The Decision, however, fails to proceed in the manner required by law in endorsing Cal Advocates' inflation factors, which the record shows only account for inflation through 2021.[112]

The Decision incorrectly concludes that "Cal Advocates calculates [the operating expense cap and operating expense budget] by using the most recent 2021 data and NECA's inflation factors of 1.013 to adjust the 2021 amount to the 2022 level and 1.042 to adjust the 2022 amount to the 2023 level."[113] This conclusion is unsupported by substantial record evidence.[114] Cal Advocates applied the inflation factor issued by NECA in 2021, and it grew that figure by one additional year of inflation using the 4.2% figure that was released by the United States Department of Commerce's Bureau of Economic Analysis ("BEA").[115] However, Ms. Ye acknowledged on cross-examination that the 1.013 NECA inflation factor she displays in Table 1-2 of her testimony as the Gross Domestic Product-Chained Price Index ("GDP-CPI") annual percentage change for calendar year 2022 is actually "measuring inflation from 2019 to 2020."[116]

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[109] D.15-06-048, App. A at 1-2; D.20-08-011, Appendix C.
[110] *See City and County of San Francisco v. Pub. Util. Comm'n* (1985) 39 Cal.3d 523, 531; *Pacific Tel. & Tel. Co*, *supra*, 62 Cal.2d at 645 ("The test-period results are 'adjusted' to allow for the effect of various known or reasonably anticipated changes in gross revenues, expenses or other conditions" to make test year calculations "as nearly representative of future conditions as possible.").
[111] D.21-06-004 at 27 ("To adjust the operating expense cap with a future test year, NECA's inflation factor should be added to the FCC's operating expense cap to true-up the historical data."); Exh. VTC-07 (*Duval Rebuttal Testimony*) at 11:9-11, 14:3-5 ("it is vital that the inflationary factors used represent the impacts that inflation will have . . . through 2023" in applying both expense limitations), 9:23-25 (Volcano uses "more accurate GDP-CPI factors for 2021 through 2023, . . . which reflect the actual inflation that occurred in 2021 and the inflation that is projected by the Congressional Budget Office to take place in 2022 and 2023").
[112] *Decision* at 19-20; *see also* Exh. VTC-07 (*Duval Rebuttal Testimony*) at 9:18-19 ("Cal Advocates' approach systematically excludes two years of inflation in computing corporate expense cap"), 13:24-26 ("Cal Advocates uses GDP-CPI factors that are three years in arrears" in the operating expense limitation.").
[113] *Decision* at 19-20.
[114] *See Volcano Opening Comments on Proposed Decision* at 7-9.
[115] *See* Exh. PAO-01 (*Ye Testimony*) at 1-4, Exh. PAO-02 (*Exhibits to Ye Testimony*), Exhibit C-13 at 12, Line 37 (4.2% GDP inflation is for 2021, not 2022).
[116] *RT* at 232:26-233:27 (Banola, Ye).

Moreover, in a NECA letter accepted into the record on December 23, 2022, NECA confirmed that the inflation factor identified in its September 30, 2021 submission measures "the price increase for costs incurred in 2019 vs. costs incurred in 2020, and is not a projection of inflation for 2022."[117] This letter and Ms. Ye's own admissions repudiate Cal Advocates' representations that the 1.180967 inflation factor in the 2021 NECA submission accounts for inflation through 2022.[118] The NECA letter and Ms. Ye's admissions irrefutably show that the Decision's inflation factor is two years short of what is needed to grow the expense caps to the test year.

The Decision acknowledges the NECA letter but states that the letter does not change its conclusion regarding its endorsement of Cal Advocates' recommended GDP-CPI NECA inflation factors.[119] The Decision irrationally finds that "the inflation factors used by Cal Advocates for calculating TY 2023 operating expenses and caps is consistent with both NECA's interpretation of the FCC rules for calculating caps, and the Commission's direction to small ILECs in D.21-06-004."[120] NECA's interpretation of the FCC rules, however, notes in relevant part:

> While this inflation adjustment [in NECA's 2021 USF Data Submission] required by the FCC's rules is used for universal service high cost loop support for 2022, it is a calculation based on actual historical data, representing the price increase for costs incurred in 2019 vs. costs incurred in 2020, and is not a projection of inflation for 2022.[121]

To comply with test-year ratemaking and the Commission's directive in D.21-06-004 "[t]o adjust the operating expense cap with a future test year" and "true-up the historical data" on which the cap is based,[122] NECA's inflation factor published in 2021 must be grown by three years of inflation. The Decision fails to follow these directives in adopting Cal Advocates'

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[117] *See Volcano Motion to Reopen the Record* (Dec. 12, 2022), Attachment 1; *ALJ Ruling Granting Motion to Reopen* (Dec. 23, 2022) at 1.
[118] Exh. PAO-01 (*Ye Testimony*) at 1-6 (Table 1-2) (suggesting 1.180967 inflation factor as accounting for inflation through 2022); *see also Cal Advocates Opening Brief* at 12 (incorrectly stating that the "inflation adjustment that was published in the prior year's NECA annual filing is used for 'Expense Incurred In' the current year.").
[119] *Decision* at 21, n. 52.
[120] *Id.*; *see also* Pub. Util. Code §§ 1757(a)(5); *City of Stockton*, *supra* ,171 Cal.App.4th at 114 ("A gross abuse of discretion occurs where the public agency acts arbitrarily or capriciously, [or] renders findings that are lacking in evidentiary support . . ."); *Zuehlsdorf*, *supra*, 148 Cal.App.4th 249, 256 (actions "not supported by a fair or substantial reason" are also arbitrary and capricious).
[121] *See Volcano Motion to Reopen the Record* (Dec. 12, 2022), Attachment 1; *ALJ Ruling Granting Motion to Reopen* (Dec. 23, 2022) at 1.
[122] D.21-06-004 at 27.

proposal, which only incorporates one additional year of inflation.[123] The Decision should be revised to adopt Volcano's proposal because it correctly incorporates two additional years of inflation into the applicable factor using GDP-CPI projections from the Congressional Budget Office, figures that the record shows are reliable and parallel to the Department of Commerce figures that NECA uses.[124] Only by using Volcano's figures will the expense figures reflected in the caps match the test year. With the necessary corrections to the inflation factor, Volcano's intrastate corporate expenses should be $1,559,575, and its operating expenses should be $8,128,020, excluding taxes.[125]

VI. THE DECISION'S REDUCTION OF TAXABLE INCOME IN RESPONSE TO BROADBAND IMPUTATION VIOLATES EXPRESS COMMISSION DIRECTIVES, UNJUSTIFIABLY DEPARTS FROM COMMISSION PRECEDENT, IS UNSUPPORTED BY THE DECISION'S FINDINGS AND SUBSTANTIAL RECORD EVIDENCE AND CONSTITUTES AN ABUSE OF DISCRETION.

The Decision's reduction of Volcano's revenue requirement by reducing test year taxable income in response to "broadband imputation"[126] fails to comply with express Commission directives, unjustifiably departs from Commission precedent, is unsupported by the Decision's findings and substantial record evidence and constitutes an abuse of discretion.[127] Specifically, this reduction fails to comply with the express directive in the CHCF-A Phase 2 broadband imputation decision that imputation impacts only rate design, and *not* revenue requirement. The Commission stated that "the rate design portion of the GRC is the proper time for consideration of broadband imputation" and that "each dollar increase in broadband imputation will result in a corresponding dollar decrease in CHCF-A support."[128] In rejecting TURN's proposed imputation approach to combine the telephone company's and the ISP's costs, in a pro forma

[123] *Decision* at 20; Exh. VTC-07 (*Duval Rebuttal Testimony*) at 15:3-21.
[124] *See* Exh. VTC-07 (*Duval Rebuttal Testimony*) at 22:23-23:1 ("Table 6 below shows the historical GDP-CPI factors reported by the Congressional Budget Office and the U.S. Department of Commerce for 2016 through 2021, and they are the same."); *see also* 47 C.F.R. § 54.1308(a)(4)(ii)(D) (confirming use of GDP-CPI in computing corporate expense cap); 47 C.F.R. § 54.303(a)(6) (confirming use of GDP-CPI in computing operating expense limitation).
[125] Exh. VTC-07-C (*Duval Rebuttal Testimony*), Exhibit CD-R1 at 3 (Lines 13, 14, 15) (Intrastate Expense).
[126] *Decision* at 25-26.
[127] Pub. Util. Code §§ 1757(a)(2)-(5).
[128] *See* D.21-04-005 at 18-19.

entity,[129] the Commission further clarified that "we decline to consider ISP affiliate operations in the determination of Small ILECs' revenue requirements."[130] The Decision arbitrarily and capriciously interprets these Commission directives by manipulating Volcano's revenue requirement in response to imputation.[131]

In addition to departing from these express Commission directives, the Decision's income tax calculation fails to follow longstanding Commission precedent and Public Utilities Code Section 275.6. Public Utilities Code Section 275.6 requires that revenue requirement be computed by adding the utility's expenses, plus its return on rate base, plus its income tax liabilities.[132] The Decision references this equation, but fails to implement it.[133] For decades, the income tax liability component of revenue requirement has been determined by multiplying the rate of return by the rate base (gross income), accounting for tax deductions (taxable income), and multiplying the resulting taxable income by the applicable tax rates (federal and state) using a "net-to-gross multiplier."[134] However, the Decision does not follow this well-established practice for determining the income tax liability component of revenue requirement. Instead, the Decision identifies Volcano's return on rate base (gross income), accounts for Volcano's tax deductions (taxable income), and then it *deducts* the ISP affiliate's net revenues from taxable income before applying tax rates to calculate the tax liability component of Volcano's revenue requirement. The Decision adopts Cal Advocates' approach, which Cal Advocates' expert witness confirmed, *subtracts* the ISP affiliate's net revenues from the income tax calculation that informs Volcano's revenue requirement.[135] In endorsing this manipulation to Volcano's revenue requirement for broadband imputation, the Commission unjustifiably departs from its practice for

[129] *See* D.21-04-005 at 18 ("TURN argues that it is just and reasonable for the Commission to take the ISP affiliates' operations into consideration when determining intrastate revenue requirement…").
[130] *See* D.21-04-005 at 18.
[131] Pub. Util. Code §§ 1757(a)(2), (5); *see also Woodbury*, *supra*, 108 Cal.App.4th at 438 ; *see also City of Stockton*, *supra*, 171 Cal.App.4th at 114; *Zuehlsdorf*, *supra*, 148 Cal.App.4th at 256.
[132] Pub. Util. Code § 275.6(b)(5).
[133] *Decision* at 16.
[134] *See, e.g.,* D.19-06-025 (Ducor), Appendix B (computing "net-to-gross multiplier" to increase gross revenue by the tax impacts of earning the rate of return on rate base specified in the rate case), D.19-04-017 (Foresthill), Appendix B (applying "net-to-gross multiplier methodology).
[135] *RT* at 265:11-15 (Banola, Ye) (admitting that "in applying broadband imputation in the results of operations, Cal Advocates made an adjustment to Volcano's revenue requirement."); *see also Volcano Amended Reply Brief* at 16. The calculations in Cal Advocates' exhibits show that it computed one revenue requirement when displaying costs, and another for tabulating the CHCF-A draw. *Volcano Opening Brief* at 39-43; *Volcano Amended Reply Brief* at 15-18. No authority permits this disconnect.

income tax calculations performed in small telephone company rate cases and fails to proceed in the manner required by D.21-04-005.[136]

As explained above, the undisputed record evidence shows that the Decision's income tax calculation improperly adjusts Volcano's revenue requirement in response to broadband imputation contrary to directives in D.21-04-005 and longstanding Commission precedent.[137] No findings in the Decision support this adjustment to Volcano's revenue requirement.[138]

VII. THE DECISION'S APPLICATION OF BROADBAND IMPUTATION RESULTS IN AN UNCONSTITUTIONAL TAKING BY CREATING AN ANNUAL SHORTFALL IN VOLCANO'S RATE DESIGN IN VIOLATION OF STATUTORY AND CONSTITUTIONAL REQUIREMENTS.

In accordance with the "broadband imputation" policy adopted in Phase 2 of the CHCF-A rulemaking, the Decision reduces Volcano's CHCF-A draw on a dollar-for-dollar basis based on the net positive retail broadband-related revenues from Volcano's ISP-affiliate, Volcano Vision.[139] The Commission's application of this policy in Volcano's rate case is unlawful because it produces an overall rate design that is insufficient to recover Volcano's revenue requirement.[140] This outcome is an unlawful taking, [141] a violation of statutory mandates,[142] and an improper imposition of public utility-type regulation on broadband service, which the FCC has deemed an "information service."[143]

While the Fifth District Court of Appeal has recently rendered a partially published opinion rejecting some of the Independent Small LECs' arguments regarding the Commission's broadband imputation policy, it found that the unconstitutional takings claim was "unripe," and

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[136] Pub. Util. Code §§ 1757(a)(2), (5); *Motor Vehicle Mfrs. Ass'n*, *supra*, 463 U.S. at 42; *McPherson*, *supra*, 189 Cal.App.3d at 308-309.
[137] Pub. Util. Code §§ 1757(a)(2), (4), (5).
[138] *Decision* at 41-42; *see also* Pub. Util. Code § 1757(a)(3).
[139] D.21-04-005 at 19, 23-24 (". . . each dollar increase in the broadband imputation amount will result in a corresponding dollar decrease in CHCF-A support."); D.23-01-004 at Appendix A, Line 1.b.
[140] Pub. Util. Code § 275.6(b)(4) ("rate-of-return regulation" requires a rate design that will "provide the company a fair opportunity to meet the revenue requirement."); Pub. Util. Code § 275.6(c)(4) (CHCF-A must be provided "in an amount sufficient to supply the portion of the revenue requirement that cannot reasonably be provided by the customers of each small independent telephone corporation after receipt of federal universal service rate support."); *see also Brooks-Scanlon*, *supra*, 251 U.S. at 399 (state commissions cannot force utilities to recover their regulated costs from unregulated operations).
[141] *Id.*
[142] Pub. Util. Code §§ 275.6(b)(3), (b)(4), (b)(5), (c)(4).
[143] *RIFO* at ¶ 20 ("We reinstate the information service classification of broadband Internet access service."); *see also* Pub. Util. Code § 202 (prohibiting Commission jurisdiction over "interstate commerce").

therefore it remains unresolved pending the outcome of this rate case.[144] Because the policy has now been implemented in Volcano's rate case and the numerical results confirm an undeniable revenue shortfall that leaves Volcano's revenue requirement unrecovered—or, alternatively, an unlawful *per se* taking of Volcano Vision's broadband revenues—Volcano and Volcano Vision now challenge the application of this policy as an unlawful taking.

As applied in this rate case, broadband imputation has created a gap of approximately $1.6 million between Volcano's *costs* and *cost recovery*.[145] The governing statute and binding constitutional takings authorities prohibit this result. Public Utilities Code Section 275.6 provides the legal framework for "small independent telephone corporation" ratemaking. Based on the Legislature's instructions, the Commission must first determine the telephone company's costs, and then fashion a rate structure that will give the company a "fair opportunity" to recover those costs.[146] As the Decision recognizes, "revenue requirement is a measurement of cost, reflecting the amount that a telephone corporation requires in order to recover its 'reasonable expenses and tax liabilities and earn a reasonable rate of return on its rate base.'"[147] By statute, "rate design" is the mix of end user rates, high-cost support, and other revenue sources that are targeted to provide a fair opportunity to meet the revenue requirement of *the telephone corporation*."[148] As a matter of constitutional and statutory law, "revenue requirement" and "rate design" must be equal.[149] If the rate design falls short of the revenue requirement, the company is denied a "fair opportunity to earn a reasonable rate of return on its investments."[150]

The Commission does not have discretion to adopt a revenue requirement and then refuse to fulfill it, but the Decision's application of broadband imputation produces this result. The adopted revenue requirement is $10,798,962,[151] but the rate design is only targeted to generate

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[144] *Calaveras, et al.*, *supra*, 2022 Cal.App.Unpub.LEXIS 7816 at *49, *51-52 (unpublished version) (finding that the "takings claims are unripe" and that the "writ proceeding does not address a decision by the Commission that sets a telephone company's rates after applying broadband imputation.").
[145] *Decision* at Appendix A, Lines 1.a, 1.b, 1.c, 7.
[146] Pub. Util. Code § 275.6(b)(4).
[147] *Decision* at 9; *see also* Pub. Util. Code § 275.6(b)(5).
[148] Pub. Util. Code § 275.6(b)(3) (emphasis added).
[149] Pub. Util. Code §§ 275.6(b)(4), (b)(3), (b)(5); *see also Pacific Tel. & Tel. Co.*, *supra*, 62 Cal.2d at 644-645; *City & Cty. of San Francisco*, *supra*, 39 Cal.3d at 531; *see also* Exh. VTC-06 (*Duval Opening Testimony*) at 19:2-5, 54:18-21.
[150] Pub. Util. Code § 275.6(c)(2).
[151] *Decision* at 2.

$9,206,788 from regulated revenue sources.[152] The Decision's application of broadband imputation reduced Volcano's CHCF-A figure by $1,592,174, which is exactly the amount of the disconnect between its revenue requirement and the revenue conferred by its rate design.[153] This annual revenue shortfall reduces Volcano expected rate of return to 3.48%, significantly lower than the 9.12% return that the Commission itself deemed necessary for Volcano.[154] This outcome is forbidden by the governing statute and creates an unconstitutional taking.

The Decision imposes a rate design that includes revenue that does not belong to Volcano, and which Volcano will not receive.[155] By "imputing" this ISP affiliate revenue into regulated ratemaking calculations, the Decision creates the illusion that sufficient funds will be available to recover Volcano's costs, but they will not. In fact, Volcano Vision's retail broadband revenues belong to Volcano Vision, which is engaged in unregulated retail broadband operations and which has its own separate cost structure and revenue needs.[156] By arbitrarily counting the broadband revenues as if they support Volcano's revenue requirement, the Commission artificially deflates the CHCF-A component of rate design, which by law must

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[152] *Id.*, Appendix A (Lines 1.a-"Total Regulated Revenue"); *see also id.* at 8-9 ("Volcano's proposed rate design includes the five categories of regulated revenue used in intrastate ratemaking, consistent with Commission precedent over the past three decades: (1) $3,277,845 in local network services revenue from Volcano's end user customers based on anticipated demand at current rates; (2) $526,979 in intrastate switched and special access; (3) $2,227,988 in High Cost Loop Support (HCLS);15 (4) $69,216 in miscellaneous revenues classified as intrastate; and (5) $5,647,436 in CHCF-A funds, prior to applying broadband imputation.").

[153] *Decision* at Appendix A, Line 1.b.

[154] *Id.* at 8, Appendix A, Lines 1.a, 2, 3 (reflecting 3.48% rate of return by subtracting operating expenses from the regulated revenue conferred by the rate design, and dividing that figure by the rate base); D.16-12-035 at 55-58 (COL 1-4, OP 1(j)) (establishing Commission-authorized rates of return necessary to generate capital for investment); *Decision* at 42 (OP 2(d)) ("Volcano Telephone Company's rate of return shall be 9.12% until the Commission adopts an adjustment pursuant to Application 22-09-003.").

[155] *Decision* at Line 1.b; D.21-08-042 at 11 (Broadband imputation does not require "the ISP affiliate to transfer funds to the Small ILEC."). Even if the Commission's purpose is to capture ISP profits, the seizure of these funds is a "per se" unconstitutional taking of unregulated, non-utility property. *See Ponderosa*, *supra*, 197 Cal.App.4th at 59-60 (seizure of returns on unregulated investments unconstitutional); *Brown*, *supra*, 538 U.S. at 233-234.

[156] *See* Exh. VTC-04 (*Lundgren Opening Testimony*) at 2 ("Volcano Vision, Inc. ('Volcano Vision') provides video and Internet access services to portions of Volcano's certificated service territory and outside of Volcano's telephone service territory in other parts of Calaveras, Amador, and Alpine Counties. In Volcano's territory, this Internet access service is enabled through Volcano Vision's purchase of wholesale DSL service from Volcano through the National Exchange Carrier Association ('NECA') FCC Tariff No. 5."); Exh. VTC-05 (*Lundgren Rebuttal Testimony*) at 9:6-7 ("Volcano's revenue requirement includes only Volcano's costs of service, not Volcano Vision's separate costs related to Volcano Vision's provision of broadband services.").

"supply the portion of revenue requirement that cannot reasonably be provided" by end user customers, federal support, and other legitimate intrastate funding sources.[157] With Volcano Vision's revenues counted—but not actually received—as Volcano's revenue, the residual function of CHCF-A is disrupted, resulting in an annual shortfall of approximately $1.6 million in this critical funding source.

This ratemaking shortfall is not just a statutory violation, but it also constitutes an unconstitutional taking of Volcano's property interest in CHCF-A support,[158] in violation of state and federal constitutional requirements.[159] Volcano will be forced to operate *every year* without sufficient revenue to meet its revenue requirement and without a reasonable opportunity to achieve its authorized rate of return. [160]

The Commission cannot evade this constitutional requirement by claiming that Volcano's shortfall will be recouped through its ISP affiliate's operations. The Supreme Court struck down similar efforts by state commissions to compel a regulated entity to suffer under unprofitable operations because the "net result of the whole enterprise" was profitable if the commission's calculations included a non-utility business.[161] *Brooks-Scanlon* concerned an unprofitable

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[157] Pub. Util. Code § 275.6(c)(4); *see also Decision* at 8-9 (confirming that "Volcano's proposed rate design includes the five categories of regulated revenue used in intrastate ratemaking, consistent with Commission precedent over the past three decades," *i.e.*, (1) local network services revenue; (2) intrastate switched and special access; (3) HCLS; (4) miscellaneous revenues; and (5) CHCF-A); Exh. VTC-06 (*Duval Opening Testimony*) at 54:18-21 ("The rate design is made up of the revenues that are designed to recover the revenue requirement. In California, the revenues that are designed to recover the revenue requirement generally come from: local rates, intrastate switched access rates, intrastate special access rates, federal HCLS, miscellaneous intrastate service rates, and the CHCF-A.").

[158] Property interests encompass any "legally enforceable right to receive a government benefit" that may be established under state law or rules. *See Board of Regents of State Colleges v. Roth* (1972) 408 U.S. 564, 576 ("The Court has held that a person receiving welfare benefits under statutory and administrative standards defining eligibility for them has an interest in continued receipt of those benefits that is safeguarded by procedural due process."), *citing Goldberg v. Kelly* (1970) 397 U.S. 254; *American Federation of Labor v. Employment* (1979) 88 Cal.App.3d 811, 819 (Property rights are not limited to property physically possessed by a party, but also include the '"legally enforceable right to receive a government benefit.'"), *quoting Goldberg*, *supra*, 397 U.S. at 261-262.

[159] *See* U.S. Const., amends. V, XIV; Cal. Const., art. I, § 19; *Duquesne*, *supra*, 488 U.S. at 308; *Hope*, *supra*, 320 U.S. at 603; *Bluefield*, *supra*, 262 U.S. at 690-693.

[160] D.20-08-011, Appendix C (Volcano's next rate case is due to be filed in 2026 with reference to a 2028 test year); D.15-06-048 at 19 (confirming that a company that does not file in accordance with the rate case plan "will be required to obtain an exemption from the Commission's Executive Director, pursuant to Rule 16.6, or wait until the first year of their next GRC cycle.").

[161] *Brooks-Scanlon Co., supra,* 251 U.S. at 397, 399 ("[a] carrier cannot be compelled to carry on even a branch of business at a loss.").

railroad with a profitable lumber affiliate whose goods traversed the railroad.[162] The Commission's application of broadband imputation is a modern version of the same unlawful scheme addressed in *Brooks-Scanlon*, where the utility was illegally compelled to continue its unprofitable utility operation based on a state commission's inferences about the profitability of its unregulated affiliated business.[163] The ratemaking requirements applicable to Volcano contain no exceptions by which "revenue requirement" and "rate design" can be calculated with reference to non-utility operations—even if those operations happen to be affiliated with the telephone company and even if the affiliate's goods or services utilize the affiliate's regulated facilities.[164] It is well established that in determining whether a rate is confiscatory, "courts do not consider the profitability of a company's nonregulated lines of business."[165]

The Decision's unprecedented calculation of the income tax liability component of Volcano's revenue requirement further confirms that broadband imputation creates a shortfall that reduces Volcano's tax liability. Specifically, the Decision improperly reduces Volcano's revenue requirement by reducing test year taxable income in response to "broadband imputation."[166] The effect is to reduce Volcano's test year tax expense, even though the broadband imputation decision states unequivocally that imputation shall impact only rate design, and not revenue requirement.[167] As a matter of law based on Public Utilities Code Section 275.6, revenue requirement must be computed by adding the utility's expenses, plus its

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[162] *Id.*
[163] *Id.*
[164] Pub. Util. Code §§ 275.6(b), 275.6(c) (ratemaking calculations concern "small independent telephone corporations," not their affiliates).
[165] *In re Rates for Interstate Inmate Calling Servs.*, WC Dkt. No. 12-375, *Third Report and Order, Order on Reconsiderations, and Fifth Further Notice of Proposed Rulemaking*, FCC 21-60 at ¶ 153 (rel. May 24, 2021) ("In evaluating the 'total effect' of a rate on a company, courts do not consider the profitability of a company's nonregulated lines of business."); *see also Calfarm Ins. Co. v. Deukmejian* (1989) 48 Cal.3d 805, 818-819 (the "continued solvency of the insurer" based on "sources unregulated by Proposition 103" "could not suffice to demonstrate that the regulated rate constitutes a fair return."); *Mich. Bell Tel. Co. v. Engler* (6th Cir. 2001) 257 F.3d 587, 594 (". . .although the plaintiffs have other unregulated income streams, they are not required to subsidize their regulated services with income from rates either deemed to be competitive, or with revenues generated from unregulated services.").
[166] *Decision* at 25-26.
[167] D.21-04-005 at 18-19 (stating that "the rate design portion of the GRC is the proper time for consideration of broadband imputation" and that "each dollar increase in broadband imputation will result in a corresponding dollar decrease in CHCF-A support."); *see also id.* at 18 (rejecting TURN's proposals to adopt a pro forma approach to imputation that combines the telephone company and the ISP, noting that "we decline to consider ISP affiliate operations in the determination of the Small ILECs' revenue requirements.").

return on rate base, plus its income tax liabilities.[168] The Decision does not follow the Commission's own directives for determining the income tax liability component of Volcano's revenue requirement, but instead identifies Volcano's return on rate base (gross income), accounts for Volcano's tax deductions (taxable income), and then *deducts* the ISP affiliate's net revenues from taxable income before applying tax rates to calculate the tax liability component of Volcano's revenue requirement. This deduction in income tax liability is premised on the assumption that Volcano is not actually receiving the ISP affiliate revenues, *i.e.*, that there is a shortfall in Volcano's rate design. This admission contradicts any notion that Volcano will be made whole under the fiction of broadband imputation. The Commission's refusal to fulfill its adopted revenue requirement for Volcano fails to proceed in the manner required by law and constitutes an abuse of discretion and unconstitutional taking.[169]

VIII. THE DECISION'S FAILURE TO INCLUDE AN EXPLICIT MECHANISM FOR REVERSING BROADBAND IMPUTATION IF BROADBAND IMPUTATION IS DEEMED UNLAWFUL CONSTITUTES AN ABUSE OF DISCRETION AND IS UNSUPPORTED BY ANY FINDING.

Because the partially published Court of Appeal decision found Volcano's and the other Independent Small LECs' takings claim was unripe and the Independent Small LECs are actively pursuing a continued appellate challenge of the Commission's broadband imputation policy,[170] the Commission abused its discretion in failing to incorporate a mechanism in the Decision to reverse broadband imputation if it is ultimately deemed unlawful.[171] In addition, the Commission's failure to incorporate such a mechanism is unsupported by any finding in the Decision itself.[172] The Decision should be modified to include an ordering paragraph to address

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[168] Pub. Util. Code § 275.6(b)(5); *see also Decision* at 16 (referencing this equation used by Volcano to compute its revenue requirement); D.19-06-025 (Ducor), Appendix B (computing "net-to-gross multiplier" to increase gross revenue by the tax impacts of earning the rate of return on rate base specified in the rate case); D.19-04-017 (Foresthill), Appendix B (applying "net-to-gross multiplier methodology).
[169] Pub. Util. Code §§ 1757(a)(2), (5), (6); *see also Woodbury*, *supra*, 108 Cal.App.4th at 438 ; *see also City of Stockton*, *supra*, 171 Cal.App.4th at 114; *Zuehlsdorf*, *supra*, 148 Cal.App.4th at 256. An agency's departure from its own precedent without adequate explanation is arbitrary and capricious. *Motor Vehicle Mfrs. Ass'n*, *supra*, 463 U.S. at 42; *McPherson*, *supra,* 189 Cal.App.3d at 308-309.
[170] *Calaveras, et al.*, *supra,* 2022 Cal.App.Unpub.LEXIS 7816 at *49, *51-52 (unpublished version); *see also* Supreme Court Case No. S278799.
[171] Pub. Util. Code § 1757(a)(5); *see also City of Stockton*, *supra*, 171 Cal.App.4th at 114; *Zuehlsdorf*, *supra*, 148 Cal.App.4th at 256.
[172] Pub. Util. Code § 1757(a)(3).

this contingency, as Volcano appropriately and timely requested.[173] The Decision fails to offer any reasoning to support its refusal to include this ordering paragraph, and none exists.

IX. CONCLUSION.

Each of the material legal errors described above requires correction under the standard of review in Public Utilities Code Section 1757. These errors deprive Volcano of CHCF-A support that is essential to satisfying its revenue requirement, while subjecting Volcano Vision to public utility regulations and manipulating its potential to derive profits from its Internet access service. The Decision also unjustifiably fails to adopt a mechanism to reverse broadband imputation, even though Volcano proposed a reasonable vehicle for these adjustments, and the Fifth District Court of Appeal recognized that the constitutional takings claims pertaining to broadband imputation are outside the scope of its Opinion addressing Volcano's facial challenge to imputation.[174] The Commission should correct each of these errors on rehearing and issue a new decision that is consistent with the law, while otherwise preserving the Decision.

Executed on this 3rd day of March 2023.

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[173] *See Volcano Opening Brief* at 63-64; *Volcano Opening Comments on Proposed Decision* at 18:22-20:5.
[174] *Calaveras, et al.*, *supra*, 2022 Cal.App.Unpub.LEXIS 7816 at *49, *51-52 (unpublished version).